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In this article, the authors analyze the European Commission's new initiative addressing the use of shell entities and arrangements for tax purposes and question its necessity.

On May 20 the European Commission launched a new initiative to fight the use of shell entities and arrangements for tax purposes. The initiative was triggered by the commission's impression that legal entities with no or only minimal substance performing no or very little economic activity continue to risk being used for aggressive tax planning structures.

This article analyzes whether those concerns are justified and clarifies the limits of substance requirements under EU law.

I. Introduction

Substance has always been important in international taxation when entities perform cross-border investment and business activities. However, awareness increased during the OECD's base erosion and profit-shifting project, which focused on substance, transparency, and coherence.

The BEPS project had a major impact on the international tax landscape. The EU adopted two anti-tax-avoidance directives (ATAD 1 and ATAD 2) requiring member states to implement several antiabuse provisions,[1] and many bilateral tax treaties have been modified through the multilateral instrument with a view to implement various antiabuse provisions, such as the principal purpose test (PPT). To increase transparency, the EU put in place a series of directives on administrative cooperation (the DAC series). The latest, DAC6 (Council Directive (EU) 2018/822), requires reporting of potentially aggressive transactions in corporate tax matters.

Hence, EU member states' tax authorities have a comprehensive arsenal of rules to tackle any kind of abusive situation, including those that require reporting, and those tools should allow them to be aware of any residual abuse. Thus, the question arises whether a new initiative that might result in ATAD 3 could elevate existing substance requirements. Further, does it serve a real need?

[1] Council Directive (EU) 2016/1164 of July 12, 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD 1); and Council Directive (EU) 2017/952 of May 29, 2017, amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD 2).

II. Substance in International Taxation

Substance is a key element in international taxation and relevant for the application of domestic tax law, tax treaties, and the arm's-length principle. While it is crucial that companies are effectively managed in their states of residence, more extensive substance requirements might derive from antiabuse provisions implemented under foreign tax law or applicable tax treaties.

A. The Notion of Substance

Substance is not a one-dimensional concept; instead, it involves several elements that may be interrelated. One element is infrastructure, which includes employees, office premises, and other facilities (such as office furniture and IT equipment). Having a website or being mentioned on the group's website, using specific email addresses, and having business cards may be details of substance. Companies can rely on their own staff and directors or outsource functions to qualified Luxembourg service providers (for example, accounting, tax compliance, and legal services).

Another element of substance is corporate governance, which concerns the composition of the board of directors, the organization of board meetings in the company's state of residence, and the involvement of qualified local directors in the decision-making process and proper documentation thereof (such as in the minutes of the board of directors, email correspondence, and internal memoranda). Further, good corporate governance requires contractual aspects to be defined in legal documentation.

Companies' functional and risk profiles can vary in relation to their investment and business activities. Typical functions performed by companies involved in investment activities include monitoring and managing investments, cash flows, and risks; analyzing investment opportunities; drafting or reviewing legal documentation, maintaining books and records; and preparing financial reporting and tax returns.

Moreover, companies may render administrative and other services to group companies, carry on treasury functions, or manage intangible property rights. When some functions are outsourced to qualified service providers or other group companies, it is for the company's directors or staff to monitor their proper execution. The functions performed and risks assumed for material intragroup transactions should be analyzed in sound transfer pricing documentation when an arm's-length price is determined.

Another element of substance concerns the commercial and legal reasons for establishing business activities in a jurisdiction. It includes features of the location, such as a flexible and diverse legal and regulatory environment, the availability of a qualified and multilingual workforce, an investor-friendly business environment, and political and financial stability. It also involves individual aspects, such as existing business relationships, investor and lender familiarity with the entity's residence state, experience with the jurisdiction's legal and regulatory system, and possibly existing substance.

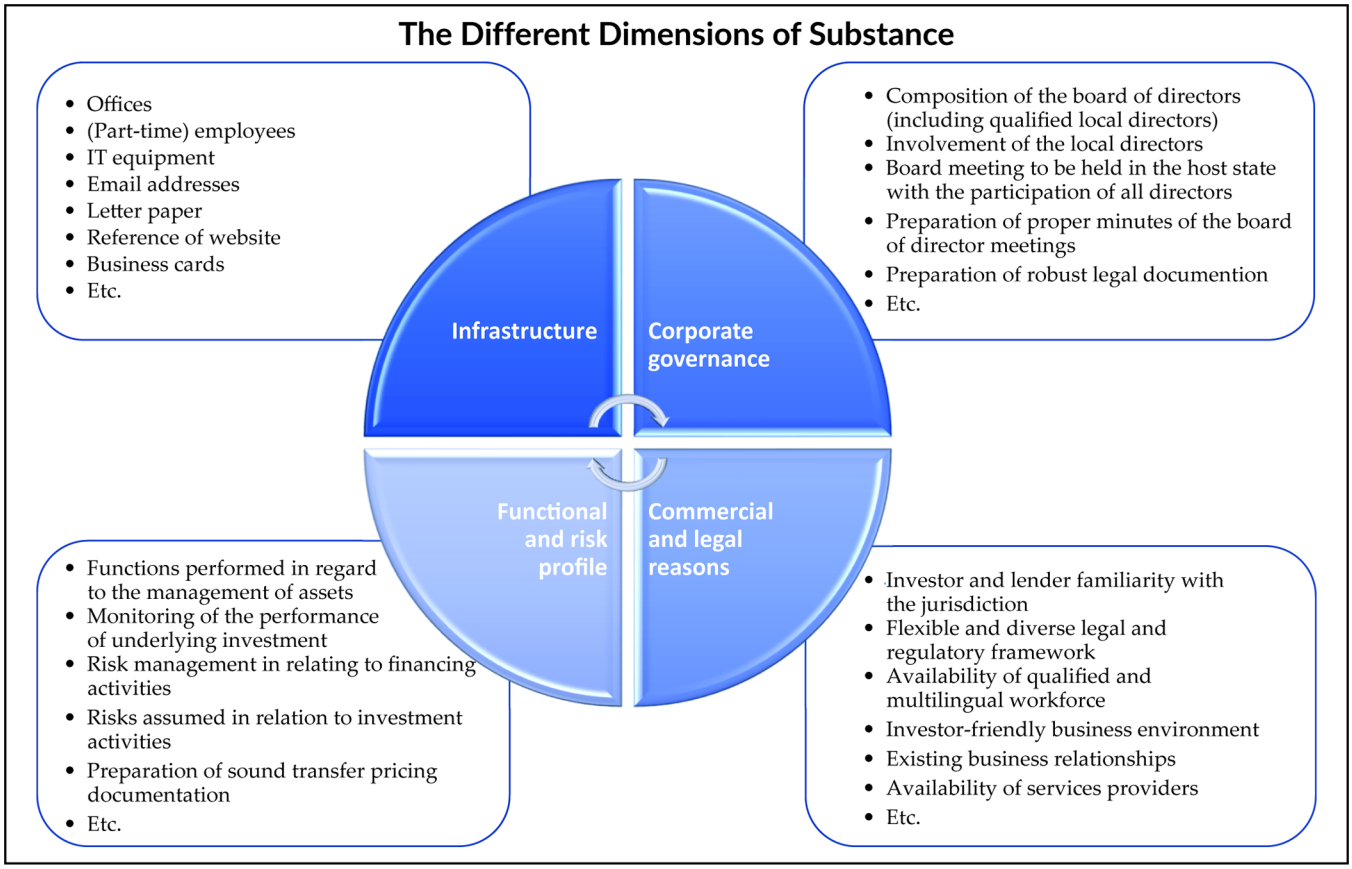
The figure depicts the different dimensions of substance.

B. Defining an Appropriate Level of Substance

When companies perform cross-border investment and business activities, they need an appropriate level of substance to mitigate tax risks. However, there is no one-size-fits-all approach. Instead, the right level of substance must be tailored to each individual case.

Many factors must be considered when determining an appropriate level of substance, including:

- The type of investment or business activities: While some activities require significant substance, others may be managed with limited substance.
- The magnitude of the activities: The need for substance also depends on the number of transactions and the related risks.
- The items of income that will be realized: In a cross-border context, foreign jurisdictions generally adopt antiabuse legislation for situations in which a nonresident company benefits from a tax advantage (for example, a reduced or zero withholding tax rate). In the absence of a tax advantage, there should be no excessive substance requirements from a foreign tax perspective.



- The jurisdictions involved: While some tax authorities are more demanding when it comes to substance, others have more reasonable expectations.
- The investment strategy: When the investment strategy relies on the realization of items of income that are not subject to foreign taxation (for example, interest income and capital gains), there should be no excessive substance requirements from a foreign tax perspective.

As a rule of thumb, a company's substance should be appropriate for the management of the activities it performs. It follows that the more activities a company performs and the higher the amounts at stake, the more substance the company should generally have. However, some activities, such as holding and financing activities, might not need an excessive level of substance.

III. The EU Initiative Against Shell Entities

The European Commission's new initiative is part of a wide-ranging communication seeking to change business taxation in the EU. Some of its key objectives are to reduce administrative burdens, remove tax obstacles, and foster a more business-friendly environment in the single market. The portion on shell companies is meant to define substance requirements for tax purposes to be met by entities in the EU.[2] While it is acknowledged that several EU actions in recent years have provided tax administrations with powerful new instruments to tackle abusive and aggressive tax structures, the European Commission still sees a need for further action.

The European Commission thinks taxpayers operating cross-border are using legal entities with no or minimum substance and no real economic activities to reduce their tax liability. The focus of the initiative is on situations in which the ultimate objective is to minimize the overall

[2]Council Directive (EU) 2018/822 of May 25, 2018, amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.

taxation of a group of companies or a given structure.

The European Commission says it has received several complaints and requests for action from the European Parliament, nongovernmental organizations, the press, and civil society, which is likely the reason it is making the proposals. Regrettably, the commission does not make even a preliminary assessment of why the measures just put in place across Europe to tackle that kind of tax abuse would be ineffective. That is all the more regrettable, given that it was responsible for drafting the measures.

A. Aggressive Tax Planning

Commission Recommendation of December 6, 2012, on Aggressive Tax Planning (2012/772/EU) defines the term "aggressive tax planning," finding that it is present when taxpayers take advantage of both a tax system's technicalities and the mismatches between two or more tax systems. In those cases, the tax treatment would not be consistent with the legislative intent.

The tax treatment of an arrangement is consistent with that intent when it relies on the application of explicit tax law (the expression of intent) or, in a cross-border context, does not take advantage of mismatches in two or more tax systems.

The transposition of ATAD 1 and 2 resulted in the adoption of the following antiabuse legislation by EU member states: interest limitation rules, controlled foreign company rules, exit tax rules, general antiabuse rules, and hybrid mismatch rules. The first three, which are specific antiabuse rules, target perceived vulnerabilities in domestic tax laws and resulted in a substantial harmonization of tax laws of EU member states. General antiabuse rules allow tax authorities to tackle non-genuine arrangements that take advantage of technicalities of the applicable tax law, and the hybrid mismatch rules eliminate outcomes (double deduction and deduction without inclusion outcomes) that result from mismatches in tax systems.

Thus, the transposition of the anti-tax-avoidance directives virtually removed the possibility of using aggressive tax planning strategies and provided EU tax administrations with far-reaching powers to challenge taxpayers.

B. An Unusual Questionnaire

The European Commission organized a public consultation and invited interested parties to share their views by August 27 in a questionnaire.[3] While we welcome public consultations, we think the nature and organization of this one raise numerous issues.

For example, the questionnaire acknowledges that the EU toolbox to fight tax avoidance was recently enhanced, with new tools coming into effect from 2019 and 2020, and asks interested parties to choose one of the following options:

- The impact of the new measures is not yet quantifiable. The EU should wait before taking new measures to fight tax avoidance until the impact of the existing measures is measurable.
- While the impact of the new measures is not yet quantifiable, there is room for improvement, so the EU should take action to complement the existing framework as soon as possible.

Hence, it is apparent that the European Commission does not even know if there is a problem but asks interested parties for their gut feelings on whether there is a need for further action. This raises the question whether the commission has authority to intervene. The pretextual legal basis for the initiative would be article 115 of the Treaty on the Functioning of the European Union on the approximation of laws of the member states that directly affect the establishment or functioning of the internal market. It is difficult to understand how one concludes whether there is a problem that in substance is an inadequacy of existing (highly technical) legislation by asking a self-selecting but otherwise unqualified random selection of members of the public.

Even the definition of shell or letterbox entities as those "with little or no substance in their place of establishment or elsewhere" seems to be unclear to the European Commission because participants have the choice of agreeing or disagreeing with it. However, in an EU context, a definition of minimum substance must consider

[3] European Commission, "Tax Avoidance — Fighting the Use of Shell Entities and Arrangements for Tax Purposes" (June 4, 2021).

the wholly artificial arrangement doctrine developed by the Court of Justice of the European Union, which requires companies to have appropriate substance.[4]

Further, while the questionnaire is addressed to all stakeholders, much of it can be answered only by people with a strong knowledge of international taxation. For example, interested parties should assess whether they (strongly) agree or (strongly) disagree with the following statements:

- shell entities are mostly used in the EU for abusive tax purposes;
- current EU tax rules provide tools to tackle aggressive tax planning schemes, including through the use of shell entities;
- current EU rules cannot fully and effectively address the use of shell entities for tax avoidance purposes; and
- while the EU legal framework includes adequate rules to address the use of shell entities for tax purposes, they are not properly implemented and monitored.

Those are highly technical questions that commission experts should answer, not questions that lend themselves to public surveys.

Another question concerns potential indicators of shell entities. Interested parties should assess whether the following elements are (very) indicative or not indicative (at all):

- use of trust and company service providers;
- low number of employees;
- lack of own premises;
- lack of own bank account;
- passive income as main source of income;
- outsourcing of income-generating activities;
- mostly foreign-source turnover; and
- most directors are nonresidents.

None of those elements on its own indicates a lack of substance; instead, the analysis requires an overall assessment of the existing substance case by case and cannot rely on a "box checking" approach.

C. Likely Economic Impact

According to the European Commission's inception impact assessment, the initiative should have two main economic effects — namely, on member states' tax revenues and on EU competitiveness.

The assessment states that an intended economic impact would be to make tax evasion and avoidance more difficult and less economically attractive, thus increasing tax revenues and eventually improving fairness in the EU. However, tax evasion is by definition a criminal offense, and tax avoidance (aggressive tax planning) has been eliminated through the transposition of ATAD 1 and 2.

The impact assessment further states that "less tax avoidance and evasion opportunities could reduce the attractiveness of the EU as a single market for incorporation of shell entities, in turn potentially decreasing the investment in the EU market." As mentioned, tax avoidance and evasion opportunities have been eliminated. However, willingly reducing the attractiveness of the EU in the current economic environment does not seem to be a sensible approach.

IV. Antiabuse Legislation

Substance requirements may be based on many antiabuse provisions implemented into EU domestic tax laws and tax treaties.

A. Domestic Provisions

Many countries in Europe (and around the globe) have adopted general and specific antiabuse rules in their domestic tax laws. Those rules generally subject the recognition of foreign companies or the granting of tax benefits on the condition that substance requirements are fulfilled.

1. Anti-Directive/Anti-Treaty-Shopping Rules

Anti-directive and anti-treaty-shopping rules allow tax authorities to challenge tax benefits such as reduced or zero withholding tax rates on dividends, interest, and royalty payments in accordance with tax treaties or the EU parent-subsidiary directive (2011/96/EU) and interest and royalty directive (2003/49/EC) if the recipient of the income does not fulfill specific substance requirements.[5] They also often use the concept of

[4] *See* Section V, *infra*.

[5] *See* Oliver R. Hoor, "The Concept of Substance in a Post-BEPS World," *Tax Notes Int'l*, Aug. 12, 2019, p. 593.

beneficial ownership, which allows reduced or zero withholding tax rates only if the income recipient is the beneficial owner thereof.

2. Hybrid Mismatch Rules

EU member states had to transpose ATAD 2, which provides a comprehensive framework to address hybrid mismatches in an EU-only context and in transactions involving third countries. It follows the OECD's BEPS action 2 recommendations for neutralizing the effects of hybrid mismatch arrangements by applying linking rules that align the tax treatment of two or more jurisdictions.[6]

Hybrid mismatches typically originate from a different tax treatment of an entity or a financial instrument under the laws of two or more jurisdictions and may result in deduction without inclusion or double deduction outcomes. The hybrid mismatch rules target mismatches between associated enterprises, structured arrangements between third parties, imported hybrid mismatches, and tax residency mismatches.

3. CFC Rules

Substance requirements might also be found in CFC rules meant to limit the use of subsidiaries established in low-tax territories (so-called base companies) to reduce (or at least defer) taxation in the parent company's state of residence by shifting income to those base companies.[7]

EU member states have implemented CFC rules in accordance with ATAD 1 to attribute, under specific conditions, income realized by low-taxed foreign subsidiaries (the base companies) to their parents, irrespective of whether those base companies distribute their profits.

4. General Antiabuse Rules

The involvement of foreign companies may be challenged under general antiabuse rules if tax authorities can show that an investment is merely tax driven or that the choice of legal instruments is an abuse of law.[8]

ATAD 1 required EU member states to implement or modify a general antiabuse rule by January 1, 2019. According to that rule, non-genuine arrangements or a series of non-genuine arrangements put into place for a main purpose of obtaining a tax advantage that defeats the object or purpose of the applicable tax law will be disregarded. Arrangements are considered non-genuine if they lack valid commercial reasons that reflect economic reality.

B. Tax Treaty Provisions

Tax treaties can include several antiabuse provisions, but substance requirements might be based in particular on the PPT and the concept of beneficial ownership.

1. Principal Purpose Test

Under the PPT, treaty benefits are denied if it is reasonable to conclude that obtaining the benefits was one of the principal purposes of any arrangement or transaction unless the taxpayer can establish that granting the benefit would be in accordance with the object and purpose of the relevant treaty provisions.[9]

The PPT was developed as part of the OECD's work on BEPS action 6, which targeted perceived tax treaty abuse. It is found in article 29(9) of the 2017 version of the OECD model and was part of the minimum standard of the MLI, which stemmed from action 15 on swiftly implementing treaty-related BEPS measures.

According to OECD guidance, the PPT requires analyzing the facts and circumstances of each case to determine whether obtaining the benefit was a principal consideration and would have justified entering into an arrangement or a transaction that has resulted in the benefit. Substance is also an element to consider when analyzing whether the PPT is met. Thus, tax authorities should not easily conclude that a principal purpose was to obtain treaty benefits.

[6] *See* Hoor, "Hybrid Mismatch Rules in Luxembourg — A Practical Guide," *Legitech* 17 (2020).

[7] *See* Hoor, "Luxembourg's New CFC Rules," *Tax Notes Int'l*, Apr. 29, 2019, p. 419.

[8] *See* Hoor, "Transformation of the Luxembourg Tax Environment Towards the Post-BEPS Era," *Legitech* 185 (2021).

[9] *See* Hoor, "Transformation," *supra* note 8, at 245, 273; and Hoor and Keith O'Donnell, "Luxembourg: Impact of the PPT on Alternative Investments," *Tax Planning Int'l* 2 (Jan. 2018).

2. Beneficial Ownership

The beneficial owner concept plays a prominent role in the tax treaty context. In essence, it is an antiabuse rule designed to prevent agents, nominees, or conduit companies from treaty shopping to provide a resident of a third state benefits on income from dividends, interest, and royalties.[10]

Under OECD model articles 10(2), 11(2), and 12(1), when dividends, interest, or royalties derived from a contracting state are paid to a resident of the other contracting state, the source state's taxing right is generally restricted to a percentage of the gross amount[11] or even excluded, as with royalties.[12] However, tax treaties typically stipulate that the person claiming the benefits must be the beneficial owner of the dividends, interest, or royalties. Thus, the source state is not bound to grant the benefits of those articles solely because the income is received by a resident of the other contracting state. Instead, the recipient must be the beneficial owner of that income.[13]

According to the guidance in the commentary to the OECD model tax convention, the term "beneficial owner" should not be used in a narrow, technical sense, but rather should be understood in its context and in light of the treaty's object and purposes, including the prevention of double taxation, evasion, and avoidance.[14] Consequently, it must be verified whether the recipient is liable for tax on the income. It should be irrelevant whether the income is actually taxed, and the test should be satisfied if the taxpayer is liable for tax on the income, irrespective of any applicable exemptions (for example, the participation exemption regime for dividends) or available loss carryforwards.[15]

C. Categorizing Shell Entities

A shell company may generally be defined as a letterbox company that has no substance whatsoever and is a "wholly artificial arrangement."

In October 2018 the European Parliamentary Research Service released a study on shell companies in the EU that found that those companies fall into three categories:

- Anonymous shell companies, which provide anonymity as a key element because the ultimate beneficial owners remain hidden behind them.
- Letterbox companies, which are registered in one EU member state but perform their substantive economic activity in another. They are sometimes used to circumvent labor laws and social contributions in the member state where the substantive activity is taking place.
- Special purpose entities, which have as their core business group financing or holding activities. They have no or few employees, little or no physical presence in the host economy, and their assets and liabilities represent investments in or from other countries.

The study further states that the main common feature of all those entities would be the absence of real economic activity — that is, no or few employees, as well as little or no production or physical presence — in the state of registration.

The implementation of the public ultimate beneficial owner registry across Europe eliminated anonymous shell companies, and the use of letterbox companies can be challenged using the antiabuse provisions described above.

Special purpose entities must be distinguished from the other types of shell entities identified in the study. They are entities through which investments are made (for example, real estate, infrastructure, private equity, and private

[10] *See* Hoor, "Transformation," *supra* note 8, at 246; and Hoor, "The OECD Model Tax Convention: A Comprehensive Technical Analysis," *Legitech* 73 (2015).

[11] Articles 10(2) and 11(2) of the OECD model tax convention.

[12] Article 12(1) allocates an exclusive taxing right to the recipient's state of residence.

[13] *See* Hoor, "The OECD Model Tax Convention," *supra* note 10; and Philip Baker, *Double Taxation Conventions and International Tax Law: A Manual on the OECD Model Tax Convention on Income and on Capital of 1992* 91 (1994).

[14] *See* para. 12.1 of the commentary on article 10; para. 10 of the commentary on article 11; and para. 4.1 of the commentary on article 12 of the OECD model tax convention.

[15] When agents, nominees, or conduit companies are not treated as the owner of the income in their state of residence, no double taxation should arise on that income.

debt investments) and which are implemented for many legitimate commercial reasons (segregation of investments, protection of the fund from liabilities, facilitation of debt funding, organization of collateral, management of investments, and so forth). When those companies properly manage their activities, they should be out of reach of antiabuse legislation.

V. Limits of Antiabuse Legislation in the EU

Antiabuse legislation might require nonresident companies to have significant substance to receive tax benefits, but in the EU, antiabuse legislation must comply with EU law as interpreted by the CJEU.[16]

Cadbury Schweppes firmly established the wholly artificial arrangement doctrine, limiting the scope of antiabuse legislation in an EU context.[17] In three other landmark cases involving German antiabuse rules and a French PPT, the CJEU reemphasized this doctrine and analyzed the compatibility of antiabuse legislation with the parent-subsidiary directive and the freedom of establishment.[18]

According to the CJEU, the objective of combating tax evasion and avoidance, whether it relies on article 1(2) of the parent-subsidiary directive or is a justification for an exception to primary law — that is, the freedom of establishment — has the same scope. Therefore, antiabuse provisions must be measures targeted specifically at wholly artificial arrangements that do not reflect economic reality and whose purpose is to unduly obtain a tax advantage.

Tax authorities should not easily find the presence of fraud or abuse. Moreover, taxpayers can rely on their EU freedoms when structuring investments, and tax jurisdiction shopping is legitimate in the internal market, even if the choice of the jurisdiction is principally based on tax considerations.

It is undisputed that member states are free to protect their tax bases via antiabuse rules directed exclusively at wholly artificial arrangements, but when assessing where there is fraud or abuse, tax authorities may not rely on predetermined general criteria. Instead, they must examine the entire operation at issue.

An abusive situation does not depend only on the taxpayer's intention to obtain tax benefits (a motive test) but also requires the weighing of objective factors, including actual establishment in the host state (for example, premises, staff, facilities, and equipment) and the performance of genuine economic activity. The CJEU does not seem to require an extensive level of substance to prove the existence of an actual establishment: As a rule of thumb, the substance should be appropriate for the activities performed by the company.

The notion of genuine economic activity should be broadly understood, and it may include the mere exploitation of assets such as shareholdings, receivables, and intangibles for deriving passive income. The nature of the activity should not be compromised if passive income is principally sourced outside the entity's host state. Also, domestic antiabuse provisions cannot require specific ties or connections between the economic activity assigned to the foreign entity and the entity's host state. Therefore, in the EU, the mere fact that an intermediary company is active in conducting the functions and assets allocated to it (rather than being a mere letterbox company) should suffice to take it out of the scope of domestic antiabuse legislation.

When analyzing the substance of a company, it is necessary to analyze not only the entity's situation but the group as a whole: It may even suffice if a company relies on the staff and premises of another group company in the same jurisdiction.[19]

Further, antiabuse legislation should not establish an irrebuttable presumption of fraud or abuse. Instead, the taxpayer must have the opportunity to provide evidence of the appropriateness of the structure.

[16] *See* Hoor, "Transformation," *supra* note 8, at 243.

[17] *Cadbury Schweppes PLC and CSO Ltd. v. Commissioners of Inland Revenue*, C-196/04 (CJEU 2006).

[18] *Deister Holding AG, formerly Traxx Investments NV, and Juhler Holding A/S v. Germany*, joined cases C-504/16 and C-613/16 (CJEU 2017); *GS v. Germany*, C-440/17 (CJEU 2018); and *Eqiom SAS, previously Holcim France SAS, and Enka SA v. France*, C-6/16 (CJEU 2017).

[19] In response to *Deister Holding*, C-504/16 and C-613/16 (CJEU 2017), on April 4, 2018, the German Ministry of Finance released a circular (IV B 3 — S 2411/07/10016-14) clarifying that the provision requiring consideration of substance only at the level of the direct parent company is no longer applicable. Hence, Germany has acknowledged that the substance of the entire group in the parent's jurisdiction must be considered when assessing potential abuse.

The imposition of general tax measures automatically excluding specific categories of taxable persons from the tax advantage, without the tax authorities being required to provide even prima facie evidence of fraud or abuse, goes beyond what is necessary to prevent fraud and abuse. Accordingly, as long as the foreign company has appropriate substance, the nature (corporations or individuals), origin, or tax status of its shareholders should be irrelevant for the application of antiabuse legislation.

From a practical perspective, however, setting up holding and finance companies with an artificially high level of equipment, facilities, and employees would be contrary to their economic nature. The simple presence of a manager monitoring the holding and finance activities of a Luxembourg company may sometimes be considered sufficient to create substance and thus prevent the structure from being (partially) disregarded under foreign antiabuse provisions. A low level of substance is the direct consequence of the specific purpose of a holding and finance vehicle and should be accepted for tax purposes, according to the CJEU.

In the same manner, a securitization company that for commercial reasons (risk limitation chiefly) cannot have employees and must use a range of independent service providers should be seen as having appropriate substance through its board of directors and the external service providers.

So far, national courts have not deviated from the CJEU's wholly artificially arrangement doctrine.

The CJEU's decisions provide a clear framework for the design and interpretation of antiabuse legislation in the EU. Notably, the wholly artificial arrangement doctrine applies to antiabuse rules both under domestic tax law and under tax treaties between EU member states.

As discussed, the wholly artificial arrangement doctrine places several limits on substance requirements. First, antiabuse provisions must focus on wholly artificial arrangements; require case-by-case analysis rather than relying on formatted criteria that automatically trigger their application; include a substance test that discharges the application of the rule when an entity has appropriate (as opposed to excessive) substance; and not result in an irrebuttable presumption of abuse or fraud — instead, they must give taxpayers the ability to provide evidence demonstrating the arrangement's appropriateness. Second, the substance analysis must consider the substance of the entire group in a jurisdiction rather than just the substance of the direct parent company. Third, economic activity is to be understood in a broad sense and includes mere asset management (even if most, if not all, of the income is derived from foreign sources). Finally, the taxpayer's motives in choosing a company's residence state are to be disregarded (as long as an entity has appropriate substance). EU parent companies should not fall within the scope of antiabuse provisions just because they are directly or indirectly owned by shareholders that are tax resident in third states.

Given that the substance of entities must be appropriate for the activities performed, there cannot be a one-size-fits-all list of substance requirements that must be fulfilled to be out of reach of antiabuse legislation. Any formatted approach will likely be incompatible with EU law.

VI. Conclusion

The European Commission's new shell company initiative is meant to restrict abuse by companies lacking substance. However, a lack of substance may already be challenged by EU tax authorities based on an all-encompassing web of antiabuse provisions that have been implemented EU-wide, throughout the OECD, and beyond. Thus, it is unclear what, if anything, is in the residual category the initiative would address.

In an EU context, substance requirements under antiabuse legislation must be consistent with EU law as interpreted by the CJEU. Thus, taxpayers are free to rely on their EU freedoms when organizing their investment and business activities as long as the underlying contractual arrangements are not wholly artificial. That limits the scope of antiabuse rules to abusive situations and would not easily allow any simplistic or arbitrary definitions of a company as being a shell. Any attempt to do so risks creating chronic legal uncertainty for years to come pending a decision by the CJEU.

In the meantime, the commission's proposal would add pointless complexity for EU businesses and reduce Europe's ability to attract international investment. ■